

April 1, 2002

To the Honorable Chairman  
of the Board of Supervisors  
of the County of Milwaukee

At its meeting on January 24, 2002 the Milwaukee County Board passed a Resolution (File No. 02-82) that authorized and directed the Department of Audit to conduct a review of the structural and procedural problems that led to the recent pension controversy. The review was to recommend ways to strengthen County procedures to ensure that policymakers receive the information they need to make informed decisions on proposed wage and benefit changes.

In this regard, we have completed our audit. Findings indicate that significant pieces of information were omitted, inaccurately presented or unsubstantiated by the administrators responsible for developing the overall strategy and supporting fiscal details for the 2001—2004 wage and benefit package. This was the responsibility of the Executive Branch of Milwaukee County government. Further, the public record does not reflect a substantive degree of questioning or scrutiny by the Legislative Branch of Milwaukee County government. The report includes a timeline of specific events that led to the problems identified and includes recommendations to strengthen this process in the future.

As directed in the above resolution, please refer this report to the Committees on Finance and Audit, and Personnel. We have also provided copies of the report to the Select Committee on Milwaukee County Government.

Jerome J. Heer  
Director of Audits

JJH/cah

Attachment

cc: Milwaukee County Board of Supervisors  
Janine P. Geske, County Executive  
James L. Forbes, Chairman, Select Committee on Milwaukee County Government  
Terry Kocourek, Acting Director, Department of Administration  
Rob Henken, Director of Research, County Board Staff  
Lauri J. Henning, Chief Committee Clerk, County Board Staff

**Audit of  
Milwaukee County's  
Development and Adoption  
of 2001—2004  
Wage and Benefit Package**

**April 2002**

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# Audit of Milwaukee County’s Development and Adoption of 2001—2004 Wage and Benefit Package

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## Summary

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In November 2000, the Milwaukee County Board of Supervisors approved, and the County Executive signed into law, a wage and benefit package affecting non-represented employees and represented attorneys for the period 2001—2004. In January and February 2001, the County Board approved, and the County Executive signed into law, various labor agreements implementing an essentially identical wage and benefit package for most employees represented by collective bargaining units. Milwaukee County has approximately 6,350 employees.

In the fall of 2001 and in January 2002, local media provided extensive coverage of potential payouts to certain long-term employees and elected officials under new pension provisions contained in the 2001—2004 package. Payouts, upon retirement, of accumulated unused sick leave balances also received extensive media coverage.

On January 24, 2002 the Milwaukee County Board directed the Department of Audit to conduct an audit of the structural and procedural problems that led to the recent County pension controversy. We focused our review based primarily on information contained in the public record and interviews with current administrative staff. Due to an active criminal investigation by the State Attorney General's Office, we did not interview principals involved in that investigation.

### Summary of Findings

Based on our review, key findings indicate:

- Significant pieces of information were omitted, inaccurately presented or unsubstantiated by the administrators responsible for developing the overall strategy and supporting fiscal details for the 2001—2004 wage and benefit package. This was the responsibility of the Executive Branch of Milwaukee County government.
- The public record does not reflect a substantive degree of questioning or scrutiny by the Legislative Branch of Milwaukee County government.
- There are no procedures for the development of fiscal notes. The practice of including only the incremental cost of multi-year packages significantly understates the full fiscal impact of the authorizing legislation.

### Major Participants

Four Milwaukee County Executive branch departments including the Department of Human Resources, Labor Relations, Corporation Counsel and Administration are involved in the process of negotiating wage and benefit packages. Other key participants in the negotiation process include

the outside actuary, Personnel Committee and Pension Study Commission. Ultimately the packages are approved by the County Board of Supervisors and County Executive.

### **Fiscal Notes**

During late 2000 and early 2001, the County Board passed 15 resolutions implementing the 2001—2004 wage and benefit package for most County employees. Deputy Sheriffs were not included in these resolutions and have not yet reached an agreement with the County on a package. The 15 resolutions each contained a required fiscal note that showed various degrees of information concerning the projected costs associated with the proposed legislation. The combined fiscal notes of the 15 resolutions, as originally reported, totaled approximately \$22.2 million. However, our review indicates the fiscal notes significantly understated the impact that could reasonably be estimated in connection with passage of the package. Specifically, we identified the following fiscal note problems:

- Omissions of information that were available or obtainable at the time the fiscal notes were prepared;
- Errors in logic in the presentation of certain components of the original fiscal notes;
- Inconsistencies in the manner of calculating the same benefit changes for separate agreements;
- Minor mathematical errors; and
- Perhaps most significantly, a conceptual approach to the calculation of fiscal notes that does not account for the continuing fiscal impact of legislation that affects multiple years.

By applying the ‘full cost’ approach to the 2001—2004 wage and benefit package, including information originally omitted, correcting for errors and using updated information, the total recalculated fiscal impact of the package is \$112 million, or about 2.5% of the estimated total Milwaukee County budget during the four-year period. Based on information available or obtainable at the time the package was passed, accurate, full cost fiscal notes would have totaled about \$96 million, or about 2.2% of the estimated total Milwaukee County budget during the period.

### **IRS Regulations**

The resolutions adopted by the County Board implementing the package contained a provision which limits pension payments as defined in Section 415 of the Internal Revenue Service (IRS) Code. The Code places caps on the maximum annual pension payments that can be paid under the County’s pension plan. Given that the cap limit is a significant amount (2002 annual limit is generally \$160,000), the vast majority of County employees do not come anywhere near the cap. Based on our review, and although a table reflecting inappropriate cap limits was used prior to

December 2001, there were no pension payments exceeding Section 415 caps. The formula used for calculations after December 2001 is currently under review by an independent actuary under contract with the Department of Audit. We do not anticipate any recommendations from the outside review, but will forward a copy of the actuary's final report to the County Board upon its completion in the next 10 days.

We appreciate the cooperation of the County administrators and staff that we contacted as we conducted this audit.

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## Background

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Milwaukee County is the largest municipal government in the State of Wisconsin, with a population of approximately 940,000 and a 2002 Adopted Budget of \$1.1 billion. As of March 2002, Milwaukee County had approximately 6,350 employees. As shown in **Table 1**, the workforce is comprised as follows:

**Table 1**  
**Milwaukee County Employees by Category**  
**March 2002**

Elected Officials	32
Executive Compensation Plan Employees	243
Non-Represented Employees	1,239
Represented Employees	<u>4,839</u>
<b>Total</b>	<b>6,353</b>

Source: Milwaukee County payroll data.

In November 2000, the Milwaukee County Board of Supervisors approved, and the County Executive signed into law, a wage and benefit package covering the period 2001—2004. Individuals affected by that package included represented attorneys and all employees not represented by a collective bargaining unit, ranging from certain clerical staff to managers and department heads in the Executive Compensation Plan (ECP), as well as elected officials. In January and February 2001, the County Board approved, and the County Executive signed into law, various labor agreements implementing an essentially identical wage and benefit package for most employees represented by collective bargaining units, also covering the period 2001—2004.

### **2001—2004 Wage and Benefit Package Highlights**

Highlights of the approved wage and benefit package include the following.

- Employees' pre-tax payroll deductions for health insurance increased from \$38 to \$80 per month for individual coverage, and from \$51 to \$100 per month for family coverage.
- Vesting rights in the Employees' Retirement System (ERS) were lowered from 10 years to five years.
- Health benefits, while largely unchanged, were modified in several ways to provide cost relief for the County. For instance, a network of preferred pharmacies was established to take advantage of volume discounts on prescription drugs.



- Individuals hired on or after January 1, 1982 were credited with a 2% multiplier (two percent of an employee's final average salary) for each year of service beginning on January 1, 2001. In addition, for each year of service completed after January 1, 2001, these employees were credited with a 2% multiplier for eight years of service prior to January 1, 2001. (The multiplier for employees hired on or after January 1982 had been 1.5% prior to passage of this package. Employees hired prior to that date already had a 2% multiplier. This internal disparity had been a source of concern and was an important factor underlying the proposed pension changes.)
- Individuals hired before January 1, 1982 were provided a bonus, added to their final average salary, of 7.5% for each year of service credit earned after January 1, 2001, up to a maximum bonus of 25% of final average salary. (This appears to be, in part, an acknowledgement that all employees would receive reduced wage increases under the package, but that only those employees hired on or after January 1, 1982 would be granted a higher multiplier.)
- A 'back DROP' (Deferred Retirement Option Program) pension benefit was established that provided individuals, upon retirement, with the option of obtaining a lump-sum payment for a portion of their pension payout, while receiving reduced monthly pension payments thereafter.
- The benefit of 'retirement leave' (the option of an individual to remain on the County payroll for purposes of liquidating payable unused sick leave balances, thus obtaining additional service time creditable for pension calculations) was eliminated. Caps on payouts for unused sick leave balances, generally set at 400 hours plus 16 hours for every additional 100 hours or fraction thereof, were also eliminated. For individuals hired prior to January 1, 1994, 100% of unused sick leave balances were paid out in cash upon retirement. (These 'pre-1994' employees and elected officials with at least 15 years of service qualify for free lifetime health care coverage upon retirement.) For individuals hired on or after January 1, 1994, 100% of unused sick leave balances were converted to a credit available to pay for continued County health care coverage into retirement. Elected officials taking office on or after January 1, 1994 were provided a credit equal to 60% of the sick leave balance that would accrue to a County employee for purposes of this health care credit benefit.
- General wage rate increases were provided in the following manner.
  1. A 2% increase effective mid-year 2001 (an effective annual increase of 1%).
  2. A 3% increase in 2002 for non-reps and a 2% initial and 2% mid-year increase for represented employees (for an effective annual increase of 3%) in 2002. (The non-represented package was subsequently modified to match the union package of a 2% initial and 2% mid-year increase, but this modification did not apply to ECP employees or elected officials).
  3. A 3% increase in 2003.
  4. A 2% initial and 2% mid-year increase (for an effective annual increase of 3%) in 2004.
- The basis for final average salary calculations, upon which pension payments are based, was established as the average of the three highest consecutive years' salaries for all employees, effective in 2003. (Previously, final average salary calculations for individuals hired on or after January 1, 1982 were based on five years, rather than three years.)
- An extra week of vacation was provided to all employees upon attainment of 15 years and 20 years of service, respectively. Further, the day after Thanksgiving was made a holiday for all employees. These changes were made effective in 2002.

In the fall of 2001 and in January 2002, local media provided extensive coverage of potential payouts to certain long-term employees and elected officials under the back DROP provision contained in the package. The provision for payouts, upon retirement, of accumulated unused sick leave balances also received extensive media coverage.

The resulting public furor over these two particular provisions of the 2001—2004 wage and benefit package led to the retirements of several top administrators, and culminated in an effort to recall the County Executive and several County Board Supervisors. The County Executive subsequently retired. A number of County Board Supervisors have publicly stated that they were misinformed or were not provided all relevant information concerning specific details and resulting fiscal impacts of some of the provisions in the 2001—2004 wage and benefit package.

### **Resolution Authorizing Audit**

At its meeting on January 24, 2002, the Milwaukee County Board passed a Resolution [File No. 02-82] that included the following clauses:

“BE IT RESOLVED, that the Department of Audit is hereby authorized and directed to conduct a review of the structural and procedural problems that led to the pension controversy and to recommend ways to strengthen County procedures to ensure that policymakers receive the information they need to make informed decisions on proposed pension and benefit changes; and

BE IT FURTHER RESOLVED, that the Department of Audit shall submit its report to the Committees on Finance and Audit and Personnel on a timely basis; and

...BE IT FURTHER RESOLVED, that the first task of the Select Committee (on County Government Structure and Procedures) shall be to review the Department of Audit report described above and recommend improvements to the procedures that govern the County's consideration of pension and benefit changes....”

### **Methodology**

Concurrent with our review, the Attorney General's Office of the State of Wisconsin was investigating the possibility of criminal misconduct on the part of top administrators who may have helped develop and lobby for passage of the 2001—2004 wage and benefit package. The Attorney General's investigation resulted from a referral from the Milwaukee County District Attorney's Office, which had received a request for an investigation by a Milwaukee County Board Supervisor. The request from the Supervisor had called into question whether or not information concerning the

2001—2004 wage and benefit package had purposely been withheld or misrepresented to County Board members. Citing a potential conflict of interest, the Milwaukee County District Attorney referred the matter to the Attorney General's Office.

Given the ongoing nature of an active criminal investigation, we opted to conduct this review based primarily on information contained in the public record. We focused our efforts on documenting the process established for developing and adopting the Milwaukee County 2001—2004 wage and benefit package. Particular focus was placed on the development and review of information presented as a fiscal note to the package. During January 2002, the Director of Human Resources, Director of Labor Relations, Corporation Counsel and Chief of Staff for the County Executive retired from their positions in Milwaukee County government. While interviews were conducted with current administrative staff to supplement our understanding of practices and procedures, we did not interview principals involved in the criminal investigation as to what information was or was not presented in private conversations or briefings. It is understood that such private conversations and briefings took place between administrators and policymakers.

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## Section 1: Wage and Benefit Package—Sequence of Events

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This section of our report will first describe, in general terms, the major players involved in developing and adopting a general wage and benefit package for Milwaukee County employees. This will outline the roles of various County departments and policymakers engaged in the process of:

- Establishing an overall strategy for developing a wage and benefit package proposal and negotiating with various employee bargaining units to implement a final wage and benefit package acceptable to policymakers.
- Developing fiscal information to affix budgetary impacts to potential wage and benefit changes for development of a specific proposal.
- Incorporating the anticipated cost of the wage and benefit package into a preliminary budget proposal before the ultimate package is negotiated and approved.
- Adapting the initial proposal to changes resulting from the negotiation process, as well as the process of budgetary approval.

After a description of these major roles, we will provide a timeline of the specific events that transpired in the development and approval of the 2001—2004 wage and benefit package.

**Four County Departments are involved in the process of developing and negotiating the various wage and benefit packages.**

### **Major Participants in Developing and Adopting Package**

Four Milwaukee County Executive Branch departments are involved in the process of developing and negotiating the various wage and benefit packages ultimately agreed upon by the various unions, approved and authorized by both the County Executive and the Milwaukee County Board of Supervisors.

***Department of Human Resources.*** Typically takes the lead role in developing wage and benefit packages, including the development of an overall strategy and supporting fiscal impact analyses. Is also involved in the negotiation sessions. Responsibility for developing the fiscal impacts of various

**The Department of Labor Relations works closely with the Department of Human Resources throughout the entire process.**

potential changes in wages and benefits continues throughout the negotiating process. May call on assistance from other County fiscal staff and/or the Milwaukee County Employees' Retirement System (ERS) contracted actuary for estimating costs of various proposals.

***Department of Labor Relations.*** Works closely with the Department of Human Resources throughout the entire process, beginning with development of overall strategy. Solely responsible for negotiating the various elements of the wage and benefit package with each collective bargaining unit representing Milwaukee County employees. (Currently, County employees are represented by 20 separate unions that are covered by eight individually-negotiated contracts.) As elements of the package are agreed upon during the negotiation sessions, Labor Relations immediately keeps the County Executive and County Board Personnel Committee Chair informed of progress made. Labor Relations also surveys Milwaukee County department heads to identify specific issues to be addressed during the negotiation process. Labor Relations staff also assist the Department of Human Resources in developing fiscal impacts of agreed upon elements of wage and benefits packages. In the 2002 Adopted Budget, the Department of Labor Relations was organizationally placed under the Department of Administration.

***Office of Corporation Counsel.*** Provides legal advice related to prospective changes to issues and wording pertaining to the various labor agreements. Attends negotiation sessions only when requested by Labor Relations. Not involved in any strategy sessions. Present during closed sessions of Personnel Committee of the County Board to provide legal guidance.

***Department of Administration.*** Provides fiscal information regarding potential percentage increases of wages when requested by Departments of Human Resources or Labor Relations. Reviews wage component of fiscal notes once

**DOA must use various techniques to, in effect, 'bury' a cost estimate of the package within the proposed budget.**

developed by Human Resources or Labor Relations. The Department of Administration (DOA) is also responsible for preparing a proposed budget that contains an estimate of the cost of a wage and benefit package long before an actual agreement is reached. For instance, while negotiations for the 2001—2004 wage and benefit package were only beginning in September and October of 2000, DOA must prepare a budget, for submission by the County Executive to the County Board, by October 1<sup>st</sup> of each year. Therefore, to prevent weakening the negotiating position of the County, DOA must use various techniques to, in effect, 'bury' a best estimate of the cost of the ultimate package within the overall proposed budget.

Other key participants in the development and adoption of Milwaukee County wage and benefit packages include the following.

***ERS Actuary.*** Under separate contract with the Department of Human Resources, the actuary hired by the Milwaukee County Employees' Retirement System Pension Board provides estimates of the cost to the County, in terms of resulting annual contributions to the pension fund, of various proposed pension benefit changes.

***Personnel Committee.*** Provides guidance to negotiating team regarding strategy to employ. Holds public hearings on tentative agreements, reviews and either rejects or approves proposed wage and benefit agreements.

***Pension Study Commission.*** Milwaukee County is the only Wisconsin county that has its own pension fund. The other 71 Wisconsin counties participate in the Wisconsin Retirement System.

**Milwaukee County is the only Wisconsin county that has its own pension fund.**

Proposed changes to the Milwaukee County ERS pension plan are reviewed by a five-member commission established by

**The County Board reviews and either rejects or approves proposed wage and benefit agreements.**

County ordinance to review and to recommend appropriate action by the Milwaukee County Board. All provisions of proposed labor agreements affecting the pension fund must be reviewed by the Pension Study Commission. By ordinance, no change to the retirement system or pension fund shall be considered by the County Board until it has been referred to the Pension Study Commission for a written report. The report on the proposed change is to advise the County Board as to the actuarial effect, the cost implications and the desirability of the proposed change.

**County Board of Supervisors.** Reviews and either rejects or approves proposed wage and benefit agreements. Ultimately, the County Board approves various resolutions implementing ordinance changes to effectuate the several labor agreements and non-represented employees package; the County Executive then has the option of signing the approved legislation into law, letting the legislation take effect by failing to sign it within 30 days, or vetoing the legislation. Finally, the County Board has the option of upholding a veto, or overriding it by a 2/3-majority vote.

### **Timeline of Specific Events**

Based on our review of available documentation, we have created a timeline of the specific events that produced the 2001—2004 wage and benefit package ultimately adopted by the County Board of Supervisors and signed by the County Executive.

**In June 1997, the Director of Human Resources seeks and is authorized by the County Board to study a ‘DROP’ retirement option.**

- **June 1997** = Director of Human Resources seeks and is granted authorization, by County Board Resolution [File No. 97-476], to study Deferred Retirement Option Program (DROP) as a potential measure to retain experienced employees. (We were unable to identify any subsequent report prepared by the Department of Human Resources on this item.)
- **January—April 2000** = The Director of Human Resources begins gathering estimates of costs associated with various potential benefit changes, as evidenced by several memos

from Pension Board actuary. Estimates of costs associated with changes in the following areas were provided:

- cost of living adjustments for retirees,
- vesting requirements,
- pension multiplier,
- health care costs (survey),
- vacation and sick time payouts, and
- pension multiplier changes, by union.

**In April 2000, the Directors of Human Resources and Labor Relations sign a joint memo to the County Executive proposing a strategy of using enhanced pension benefits as a means of limiting general wage increases, which have a greater impact on tax levy.**

- **April 2000** = The Director of Human Resources and the Director of Labor Relations sign a joint memo to the County Executive proposing an overall strategy of implementing many of the benefits ultimately included in the wage and benefit package as soon as possible for non-represented employees. The memo stated that such action would encourage the various labor organizations to commence serious discussions and possibly allow the execution of a final agreement with one or more of the larger unions prior to finalizing the 2001 budget. The memo further stated that the benefits were "...designed to recruit new employees while retaining our current workforce; and will help to ensure a low general wage rate increase for three to four years in the future." The memo also noted the strategy of using enhanced pension benefits as a means of limiting general wage increases, which have a greater impact on tax levy. The memo noted that "A general wage adjustment results in a permanent increase in the tax levy, while an increase in pension benefits may be funded by the earnings of the pension fund."
- **June 2000** = Information gathering and strategizing continues as the Executive Branch develops an overall approach for development of a package agreeable to all parties—the County Executive, County Board and union representatives. In the month of June, records indicate the following.
  - The Director of Human Resources and Director of Labor Relations outline a proposed labor negotiation strategy in a memo to the County Executive.
  - In response to questions from County Executive, Director of Human Resources obtains from actuary estimates of annual costs for various pension benefit changes based on assumptions of 0%, 5%, 8.5% and 12% investment earnings, respectively.



- Director of Human Resources obtains information on the average number of sick leave hours paid out to employees upon retirement from the Department of Human Resources Compensation Manager.
- **July 2000** = Personnel Committee meets in closed session regarding collective bargaining issues.
- **July—September 2000** = Initial proposals exchanged and negotiations begin between County Labor Relations and various collective bargaining units.
- **September 2000** = Budget meeting attended by County Executive and representatives of the County Executive's office staff, Department of Administration, Department of Human Resources and Department of Labor Relations. A negotiations goal was established that would result in an estimated 2001 wage and benefit package tax levy impact of \$5.1 million, comprised of the following estimates:

Health Insurance Savings	(\$5.5M)
Pension Revisions	8.5M
2% General Wage Increase (7/01)	<u>2.1M</u>
Total	\$5.1M

- **September 2000** = Personnel Committee meets in closed session re: update from staff that all collective bargaining unit negotiations have begun.
- **October 2000** = Several key pieces begin to fall into place for ultimate passage of a wage and benefit package, including the following.

**In October 2000, the Director of Human Resources recommends that the Pension Study Commission and Personnel Committee approve the package for non-represented employees.**

- The attorneys' union ratifies a tentative wage and benefit agreement.
- The Director of Human Resources recommends that the Personnel Committee and the Pension Study Commission approve a wage and benefit package for non-represented employees. A report signed by the Director of Human Resources contains a fiscal note identifying a 2001 cost of the recommended revisions to wages and benefits of "...\$1,099,679 or the equivalent of 1.2% of the total payroll for non-represented employees." Both bodies approve the package.
- The Personnel Committee approves the attorneys' tentative agreement. The fiscal note on the agreement indicates additional costs for the contract terms, which apply to 33 attorneys, were approximately \$78,000 for 2001, \$72,000 for 2002, \$72,000 for 2003 and \$145,000 for 2004. In closed

session, the Personnel Committee discusses collective bargaining issues.

- **November 2000** = The County Board passes resolutions implementing both the attorneys' agreement and the wage and benefit package for non-represented employees. The packages, with minor variations relating to the attorneys' wage structure, are virtually identical and cover the period 2001—2004. The County Executive signs the resolutions.
- **November 2000** = The Director of Human Resources schedules open sessions for non-represented employees to explain the 2001—2004 wage and benefit package enacted.
- **December 2000** = Personnel Committee meets in closed session to discuss negotiations of labor agreements with collective bargaining units.
- **January 12 and 18, 2001** = Activity intensifies as several collective bargaining units ratify agreements. The Personnel Committee approves tentative agreements with several different unions, either at its regular meeting on January 12 or at a special meeting held on January 18 (the day of the full County Board meeting).
- **January 16, 2001** = A memo to the Director of Human Resources from the actuary estimates the annual cost in terms of a contribution by the County to the pension fund of \$718,000 for the back DROP provision. This is the first time a cost has been identified with the benefit change.
- **January 18, 2001** = The County Board passes resolutions approving a 2001—2004 wage and benefit package for several unions. The County Executive later signs this legislation.
- **February 9, 2001** = Memo from Director of Human Resources to County Board Research staff analyst provides back DROP information for a hypothetical County employee. By omission, this memo creates false impression that pension fund is better off financially as a result of employee's choice to take a \$255,000 lump sum back DROP payment. (The memo notes that the example shows an ultimate savings to the pension fund due to lower monthly payments to the employee choosing the back DROP option. However, it fails to take into account the loss of investment income to the pension fund due to the outlay of a lump sum payment.)

**A January 16, 2001 memo is the first time a cost has been identified with the back DROP benefit change.**

**In a February 9, 2001 memo the Controller indicates he had not been informed of benefit changes already approved for some employees.**

A separate memo from the Controller (Department of Administration) to external auditors indicates the County's chief accounting official had not been informed of changes, already approved for non-represented employees and those employees represented by several unions, providing for full

payout of unused sick leave balances upon retirement. (This change resulted in additional accounting liabilities that must be acknowledged and funded under Generally Accepted Accounting Principles.)

- **February 9, 2001** = Personnel Committee approves tentative agreements with two additional unions, including District Council 48, the union that represents the largest number of County employees.
- **February 15, 2001** = The County Board passes resolutions approving a 2001—2004 wage and benefit package for the two additional unions recommended by the Personnel Committee. The County Executive later signs this legislation. As a result, the Sheriff's Deputies union is the only employee group that has not reached agreement with the County on a wage and benefit package.

### **Subsequent Events**

- **February 28, 2001** = The Director of Human Resources provides updated information to the County Executive on the impact of benefit changes on the estimated County contribution to the pension fund.
- **March 2001** = The Director of Human Resources obtains additional information from staff concerning sick leave usage and potential payouts upon retirement.
- **March 2001** = Actuary provides Internal Revenue Service (IRS) Code s. 415 Maximum Annual Benefit Limit Table to Employee Retirement System (ERS) for use in manually identifying employee retirement options under the back DROP provision that could potentially exceed IRS limits. However, the table provided by the actuary is inappropriate for the Milwaukee County plan, and incorrectly allows for limit increases each year after age 65. (A subsequent review by the actuary of retirement calculations made using the inappropriate table resulted in the conclusion that no retirement payments were made in excess of the IRS limits.)
- **April 2001** = Memo from Director of Human Resources and Fiscal and Budget Administrator to County Board acknowledging failure to identify impact on 2000 County budget of \$4.3 million due to sick leave payout change, as well as additional millions unbudgeted for 2001 (to be absorbed by County departments).
- **July 2001** = Director of Human Resources and the actuary brief County Board members on strategy behind 2001—2004 wage and benefit package, as well as costs and savings associated with the package.

**An April 2001 memo from DOA and Human Resources acknowledges failure to identify \$4.3 million dollar impact on budget due to sick leave payout change.**

- **September 2001** = Pension Board approves increasing assumed annual investment return from 8.5% to 9.0% and reducing the period over which plan changes are amortized from 35 years to 20 years.
- **October 2001** = Local web site (www.milwaukeeeworld.com) contains story about potential for some long-time County employees and elected officials to receive lump sum back DROP payments in excess of \$1 million in 2008.
- **October 2001** = Memo from actuary to Director of Human Resources revises estimated annual cost of back DROP benefit change, from \$718,000 to \$985,000.
- **December 2001** = Milwaukee Magazine article expands on October web site story concerning potentially large back DROP payments.
- **December 2001** = County Board Research staff prepare an issue paper regarding the 2001—2004 wage and benefit package. It is during this process that County Board staff first become aware of a cost associated with the back DROP benefit.
- **December 2001** = Actuary provides correct IRS Code s. 415 Maximum Annual Benefit Limit Table to the ERS. This table correctly caps pension payments and does not increase for any age group.
- **January 2002** = Series of articles on back DROP benefit and other provisions of the 2001—2004 wage and benefit package begins in the Milwaukee Journal-Sentinel. (Back DROP figures initially developed and reported by the newspaper are in excess of those allowed under the plan, which incorporates IRS Code s. 415 limits. However, payments in excess of \$1 million are possible for some employees and corrected figures are later printed by the newspaper.)
- **January 2002** = Recall efforts are launched against County Executive and ultimately 12 of 25 County Board Supervisors.
- **January 2002** = County Board passes Resolution [File No. 02-56] requiring the Director of Labor Relations, prior to agreeing to any tentative contract, provide the Director of Administration, Director of Audits and County Board staff with a copy of the proposed agreement for review relative to immediate and long-term fiscal impacts.
- **February 2002** = Report from Director of Audits and Director of County Board Research indicates that the additional fiscal liability associated with the change in unused sick leave payout benefits for employees eligible to retire in 2002 alone

**In January 2002 a series of articles on the back DROP benefit and other provisions begins in the Journal-Sentinel.**

**A February 2002 report from Director of Audits and Director of County Board Research indicates additional \$15.9 million liability associated with unused sick leave payout benefit for employees eligible to retire in 2002.**

was \$15.9 million. The report notes that, while not likely to be incurred in a single year, the likelihood of those particular employees eventually retiring from County service was high, with the liability likely to grow as employees accumulate additional sick leave. (This item was omitted from the fiscal notes for the 2001—2004 wage and benefit package under the premise it was a no-cost item.)

**County Board passes resolution in February 2002 to modify and rescind portions of the package for elected officials and all non-represented employees.**

- **February 2002** = In response to request from Chairman of the Finance and Audit Committee, actuary provides updated estimates of back DROP cost under different assumptions of participation. Included in the actuary's report is an updated back DROP cost resulting from recent change in assumed pension fund investment returns (the same rate used to calculate interest applied to back DROP lump sum payments) and change in ERS plan amortization period. Due to these changes, the actuary updates the estimated annual cost of back DROP from \$985,000 to \$1,443,000.
- **February 2002** = County Board passes Resolution [File No. 02-131] to modify and rescind portions of the 2001—2004 wage and benefit package for elected officials and all non-represented employees, including ECP employees. In particular, pension back DROP and unused sick leave payout enhancements are eliminated for future hires; former cap of 400 hours plus 16 for every 100 or fraction thereof are placed on payment of unused sick leave for non-represented/ECP employees. (A class action lawsuit on behalf of non-represented employees is initiated shortly after passage of this legislation.)
- **February 2002** = County Executive resigns.
- **February 2002** = Select Committee on County Government Structure and Procedures, created by County Board Resolution [File No. 02-82], holds an organizational meeting to map out process for recommending reforms for Milwaukee County governance.

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## Section 2: Fiscal Note for 2001—2004 Package

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**The 15 resolutions implementing a wage and benefit package for most County employees each contained their own separate fiscal note.**

During late 2000 and early 2001, the Milwaukee County Board of Supervisors passed 15 resolutions implementing a wage and benefit package for most County employees for the period of January 1, 2001 through December 31, 2004. Deputy Sheriffs were not included in these resolutions. These resolutions were each reviewed and approved by the Personnel Committee and, subsequently, the full County Board.

The 15 resolutions each contained a required fiscal note that showed various degrees of information concerning the projected costs associated with the proposed legislation.

Milwaukee County Ordinances state, in part:

### **1.10. Fiscal notes.**

(1) No resolution, ordinance or communication from any county officer, board or commission shall be considered by the county board, or by any committee thereof to which it has been referred, unless it shall have attached as a note a reliable estimate of the fiscal effect or absence of the same....If a member objects to the content of a fiscal note attached to a resolution or ordinance under consideration by the county board, such resolution or ordinance shall, upon the affirmative vote of a majority of the members present and voting, be referred to the county board staff for a review and report to the county board at its next meeting.

The resolution for wages and benefits concerning non-represented employees showed the estimated dollar impact on the first year and estimated percentage changes for years two through four. The remaining 14 resolutions impacted employees represented by seven different unions. Each of the union agreements were addressed with two resolutions, one which impacted 2001 and a second which impacted years 2002—2004. For purposes of this analysis we have combined the fiscal notes of all the resolutions implementing the 2001—2004 wage and benefit package for Milwaukee County employees, as shown in

**Table 2.** It should be noted that the information in **Table 2** was never presented in this summary fashion. Rather, separate fiscal notes were attached to each of the 15 resolutions that collectively implemented the wage and benefit package for all Milwaukee County employees except approximately 673 Deputy Sheriffs, with whom the County has not yet reached agreement on a package.

**Table 2** shows the combined fiscal notes of the 15 resolutions as originally reported for the four-year period.

<b>Table 2</b> <b>2001-2004 Wage and Benefit Package</b> <b>Original Fiscal Notes</b>	
Wage Increases	\$18,714,658
Wage Related Items (shift differential, etc.)	940,476
Health Plan Benefit Changes	(2,068,911)
Increased Premiums for Employees	(1,714,752)
Pension Changes	6,296,771
Other	33,793
<b>Four-Year Total</b>	<b>\$22,198,025</b>
Note: The original fiscal notes contained minor math errors. As a result, the total recorded in the fiscal notes understates the sum of the line items by \$1,422. There was no itemization of the back DROP benefit or sick leave payout enhancement, which impacts were assumed to be zero.	
Source: Compiled from 15 separate County Board resolutions.	

**The fiscal notes, as originally reported, significantly understated the fiscal impact of the wage and benefit package.**

We reviewed the fiscal notes and conducted our own independent verification of the underlying data upon which the fiscal notes should properly have been based. Our review indicates the fiscal notes, as originally reported, significantly understated the fiscal impact that could reasonably be estimated in connection with passage of the 2001—2004 wage and benefit package.

Our review of the original fiscal notes identified the following problems:

- Omissions of information that were available or obtainable at the time the fiscal notes were prepared;
- Errors in logic in the preparation of certain components of the original fiscal notes;
- Inconsistencies in the manner of calculating the same benefit changes for separate agreements;
- Minor mathematical errors; and
- Perhaps most significantly, a conceptual approach to the calculation of fiscal notes that does not account for the continuing fiscal impact of legislation that affects multiple years.

Following is a more detailed explanation of the problems identified during our review of the original fiscal notes for each line item in **Table 2**.

### **Omissions of Information**

One problem identified as a result of our review of the fiscal notes for the 2001—2004 wage and benefit package was the omission of certain information that was either available or obtainable at the time the fiscal notes were prepared. Key among these omissions was the absence of a cost for the establishment of a back DROP pension benefit.

### Back DROP

In what may have been, in retrospect, the most significant omission from the fiscal notes for the wage and benefit package, there was no fiscal impact attached to the controversial back DROP benefit. None of the actual fiscal notes accompanying the 15 resolutions implementing the 2001—2004 wage and benefit package referenced the back DROP provision in any way.

**Key among fiscal note omissions was the absence of a cost for the establishment of a back DROP pension benefit.**

**Documents indicate that no cost was attributed to the establishment of a back DROP benefit.**

Documents indicate that the Director of Human Resources attributed no cost to the establishment of a back DROP benefit. However, the actuary indicates that the Director of Human Resources did not initially request cost information regarding the proposed back DROP benefit. Rather, in December 2000, one



**Fiscal notes were not revised to include back DROP cost information provided by the actuary.**

month after approval of the benefit as part of the package affecting non-represented employees, the actuary expressed concern about assuming a neutral fiscal impact for the back DROP benefit. According to the actuary, the Director of Human Resources verbally instructed the actuary to look into the issue. Documents show that the actuary's written response, dated January 16, 2001, placed an estimated annual cost to the County (in the form of annual contributions to the pension fund) of \$718,000 on the back DROP benefit. Even though this information was provided to the Director of Human Resources prior to the passage of resolutions implementing the back DROP benefit for several unions representing Milwaukee County employees, the fiscal notes were not revised to include this information.

Further, it appears this information was not formally communicated to the County Board. According to County Board Research staff, their first indication of a cost associated with the back DROP benefit came as they gathered information for an issue paper released in December 2001.

#### Added Vacation and Holiday Time

**No cost was placed on the addition of extra vacation and holiday time.**

No cost was placed on the addition of one week of vacation for new hires after six months of employment (previously, employees had to work a full year before earning vacation time). Similarly, no cost was placed on the addition of one week of vacation for 15-year veteran employees (from four to five weeks) and 20-year veteran employees (from five to six weeks), respectively. Further, the day after Thanksgiving was added as a 'floating' holiday, permitting all employees to take off that day, or any day of their choosing, within six months of that date. Again, no cost was placed on this additional holiday time. Each of these provisions took effect beginning in 2002.

However, to the extent that the County has certain activities that operate on an around-the-clock basis (e.g., County jail

operations, mental health inpatient care, certain facilities management and information technology duties, etc.), overtime must be incurred to replace individuals who are absent from their posts. Therefore, based on estimates provided by affected departments, we estimate the annual cost of the additional leave time (beginning with the second year of the 2001—2004 wage and benefit package) to total about \$350,000 annually, or about \$1 million over the course of the package.

**The fiscal note in the package for non-represented employees does not include dollar figures for the second through fourth years.**

#### Lack of Specificity/Quantification

The fiscal note contained in the resolution implementing the 2001—2004 wage and benefit package for non-represented employees does not include dollar figures for the second through fourth years. Rather, the fiscal note expresses a total fiscal impact of \$1,099,679 for 2001 (\$902,809 attributed to wages) and contains a narrative description of the fiscal impacts in the remaining years, as follows:

“In future years the fiscal effect equates to a wage increase of 3% in 2002, 3.18% in 2003 and 3% in 2004.”

This above language combines the impact of at least six separate line items that could be fashioned (as shown in **Table 2**) for this fiscal note. Further, it expresses the total impact in terms of a percentage of wages, but never provides the base wage amount necessary to quantify the impact. Consequently, as stated, this fiscal note is of questionable usefulness for years 2002—2004.

#### **Errors in Logic**

The fiscal impact attributed to another major benefit change, the full payment of unused sick leave balances upon retirement, was also omitted from the original fiscal notes. In this case, the omission resulted from an error in logic. An April 2000 memo to the County Executive on labor negotiating strategy, signed by the Director of Human Resources and the Director of Labor

Relations, contained attachments detailing several options. One attachment stated,

“In 1999, the average employee who retired from County service received payment for 267 hours of accrued sick allowance. Based on our experience in 1999, this benefit [full payment of unused sick leave, with no caps] is unlikely to result in any added cost to the County....”

The conclusion that the County would incur no added cost from eliminating the cap on payouts (generally 400 hours, plus 16 hours for every 100 additional hours or fraction thereof) comes from an error in logic. The conclusion is based on the assumption that, since the average **payout** for 1999 retirees was 267 hours, then the average unused sick leave balance **available** to those individuals was also 267 hours. In fact, because payouts in 1999 were limited by the ‘400 plus 16’ cap, all hours in excess of the cap are not included in the 267-hour average.

**The actual payout for sick leave balances in 1999 would need to be multiplied by a factor of about 1.9 to estimate the annual fiscal impact.**

Our independent review of 1999 data indicates that for 137 employees who retired and were eligible for sick leave payouts, a total of 32,773 hours were paid. However, for those same 137 employees, unused sick leave hours in excess of the cap, and thus not paid, totaled 29,455 hours. The resulting ratio of sick hours available to sick hours paid is therefore about 1:1.9 ( $32,773 + 29,455 = 62,228$ ;  $62,228/32,773 = 1.9$ ). Based on this data, the actual payout for sick leave balances in 1999 would need to be multiplied by a factor of about 1.9 to estimate the annual fiscal impact of the change in sick leave payout policy.

### **Inconsistencies**

In reviewing the fiscal notes of the 15 resolutions implementing the various labor agreements and the non-represented package that collectively make up the Milwaukee County 2001—2004 wage and benefit package, we found inconsistencies in how certain calculations were made for the fiscal note contained in one resolution vs. another. For example, in the fiscal note

**The annual fiscal impact of increased employee health care premiums understated savings by \$1.4 million.**

accompanying the resolutions affecting employees represented by District Council 48, the annual fiscal impact of increased employee health care premiums understated savings by \$1.4 million. The additional employee payments of \$438,396 noted in the fiscal note represents only those employees who participate in conventional care plans. Those employees enrolled in HMO plans account for the additional increased payments not included in the original fiscal notes. A similar oversight occurs with the fiscal note for the resolutions affecting the Machinist's union. However, the same problem is not present in the resolutions affecting the other five unions.

An additional inconsistency occurs in the manner in which the savings from additional employee premium payments are reported in the various fiscal notes. The fiscal notes for resolutions affecting three of the unions list a savings only for the first year of the four-year wage and benefit package. The fiscal notes for the resolutions affecting the other four unions, however, list savings in each of the four years in the total package.

### **Minor Math Errors**

Several minor math errors were noted in the calculations of the various fiscal notes. None of these made a material difference in the fiscal note totals.

### **Adjusted Fiscal Note**

Adjusting for omissions, errors in logic, inconsistencies and math errors, we calculate that the \$22.2 million fiscal note developed for the 2001—2004 wage and benefit package should have been reported as \$34.4 million. However, we have identified a separate fundamental problem in the way this and other fiscal notes have been prepared by Milwaukee County.

**Adjusting for omissions and errors, the \$22.2 million fiscal note total should have been reported as \$34.4 million.**

**We identified a conceptual issue that singularly surpasses in significance all other errors and omissions.**

### **Conceptual Approach to Fiscal Notes: Incremental vs. Full Cost**

In reviewing the fiscal notes for the 2001—2004 wage and benefit package, we were initially struck by the lack of specificity and near absence of any detail included in the notes, especially considering the complex nature of the package. Upon further review, we identified a conceptual issue that singularly surpasses in significance all the errors and omissions previously identified in this section. That conceptual issue is the practice of listing only the annual incremental cost of a proposed piece of legislation covering multiple years, as opposed to the full cost of the action.

To illustrate, assume a wage and benefit package covering four years included annual general increases of 2%. If the wage base in the beginning of the four-year period is 100, a fiscal note using the incremental approach would show a total fiscal impact of 8.24, as shown in **Table 3**.

<b>Table 3</b> <b>Illustration of Incremental Approach to Fiscal Notes</b>						
	<u>Beg.</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Total</u>
Wage Based	100	102	104.04	106.12	108.24	
Incremental Cost		2	2.04	2.08	2.12	<b>8.24</b>
Source: Department of Audit.						

Using the same data and assumptions, a full cost approach would produce a much different total fiscal impact, as shown in **Table 4**.

**Table 4**  
**Illustration of Full Cost Approach to Fiscal Notes**

	<u>Beg.</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Total</u>
Wage Base	100	102	104.04	106.12	108.24	
1 <sup>st</sup> Year		2	2	2	2	<b>8</b>
2 <sup>nd</sup> Year			2.04	2.04	2.04	<b>6.12</b>
3 <sup>rd</sup> Year				2.08	2.08	<b>4.16</b>
4 <sup>th</sup> Year					2.12	<b>2.12</b>
<b>Annual Totals</b>		<b>2</b>	<b>4.04</b>	<b>6.12</b>	<b>8.24</b>	
<b>Full Cost Total</b>						<b>20.4</b>

Source: Department of Audit.

**The full cost of this hypothetical four-year wage package is substantially higher using the full cost approach.**

As shown in **Tables 3** and **4**, the full cost of the four-year wage package used for illustrative purposes is substantially higher using the full cost approach (20.4) as opposed to the incremental approach (8.24). This is because the incremental approach does not account for the cumulative impact of each year's wage increases in succeeding years. These costs are, in essence, treated as 'fixed costs,' just as the wage base (total payroll) is not included in the fiscal note using either the incremental or full cost approach. However, given that the fiscal note is intended to provide legislators with the full fiscal impact of the changes upon which they are voting, we believe the full cost approach is more informative and in keeping with an overall public interest in full disclosure. Further, the full cost approach contains all of the information included in the incremental approach.

**Table 5** presents, using the full cost approach, the Department of Audit's recalculation of the overall fiscal note for the 15 resolutions passed in late 2000 and early 2001 implementing the 2001—2004 wage and benefit package. The data in **Table 5** includes data omitted from the original fiscal notes, corrections for errors in logic and math, as well as updated information on health care plan modifications, the back DROP benefit and sick leave payout based on actual experience during 2001, and a subsequent action to modify the 3% general wage increase in

2002 to 2% at the beginning of the year and 2% at mid-year for all non-represented employees (excluding ECP employees).

**Table 5**  
**Department of Audit**  
**Recalculation of 2001—2004 Wage and Benefit Package**  
**Full Cost Approach**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Total</u>
Wages*					
2001	\$3,100,572	\$5,822,649	\$5,822,649	\$5,822,649	\$20,568,519
2002		7,881,858	10,170,842	10,170,842	28,233,542
2003			8,142,102	8,142,102	16,284,204
2004				8,440,757	8,440,757
Wage Related Items					
(signing bonus, shift differential, etc.)	1,050,306	246,194	240,974	240,974	1,778,448
Health Care Plan Modifications	(2,667,169)	(3,119,369)	(3,657,487)	(4,297,847)	(13,741,872)
Employee Health Care Contribution	(2,856,924)	(2,856,924)	(2,856,924)	(2,856,924)	(11,427,696)
Pension Changes (excluding back DROP)	8,488,000	11,958,000	13,350,690	14,084,978	47,881,668
Back DROP Pension Change	938,000	1,480,000	1,561,400	1,647,277	5,626,677
Sick Pay Payout Change	889,473	3,839,031	587,164	1,594,320	6,909,988
Additional Vacation and Holiday	0	344,985	355,334	367,527	1,067,846
Other	16,426	16,426	16,426	16,426	65,704
<b>Total</b>	<b>\$8,958,684</b>	<b>\$25,612,850</b>	<b>\$33,733,170</b>	<b>\$43,373,081</b>	<b>\$111,677,785</b>

\*Wages and payroll taxes totaled \$252 million in 2000 (excluding Deputy Sheriffs).

Source: Calculated from various sources by Department of Audit.

**Our recalculated fiscal note identifies the total fiscal impact of the four-year package as approximately \$112 million, or about 2.5% of the estimated total Milwaukee County budget during that period.**

**Table 5** shows the results of applying the full cost approach to the 2001—2004 wage and benefit package. By including information originally omitted, correcting for errors and using updated information, this recalculated fiscal note identifies the total fiscal impact of the 2001—2004 Milwaukee County wage and benefit package as approximately \$112 million, or about 2.5% of the estimated total Milwaukee County budget during that period. Annual costs range from \$9 million in the first year to \$43.4 million in the fourth year averaging \$28 million per year.

It should be noted that updated information for the health care plan changes, back DROP and increased sick leave payout benefits, based on actual experience in 2001, accounted for a total of about \$16 million of the \$112 million. Therefore, based

on information available or attainable at the time the 2001—2004 wage and benefit package was passed, accurate, full cost fiscal notes would have totaled about \$96 million, or about 2.2% of the estimated total Milwaukee County budget during the four-year period.



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## Section 3: Regulatory Limits on Pension Payments

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**The Internal Revenue Code places caps on annual pension payments.**

The resolutions adopted by the County Board implementing the 2001—2004 wage and benefit package contained a provision which limits pension payments as defined in Section 415 of the Internal Revenue Service (IRS) Code. This section of the Code places caps on the maximum annual pension payments that can be paid under the County's pension plan. For 2002, that annual limit is generally \$160,000. Specific reference is made in the language adopted by the County Board to include back DROP payments in the calculation of the limits. This is accomplished by developing an actuarial value of a lump sum back DROP amount which is added to the reduced pension to determine compliance with the cap. Given that the limit is such a significant amount, the vast majority of County employees do not come anywhere near the cap. However, the impact of noncompliance with the Code is significant because failure to comply could place the tax exempt status of the plan in jeopardy.

**Although a table reflecting inappropriate limits was used, caps were not exceeded.**

Because of the importance of following Section 415 of the IRS Code, staff of the ERS worked closely with the ERS actuary to ensure that annual limits were accounted for in calculating monthly pensions and back DROP amounts. By March 2001, ERS staff were verifying calculations against a table to gauge compliance. According to ERS staff, it was subsequently determined in December 2001 that the table provided by the actuary, and in use until that time, was not the proper schedule given the structure of the Milwaukee County pension plan. We conducted a review of pension calculations to determine whether any payments were issued in conflict with the Code and County Ordinances. We conclude that, although a table reflecting inappropriate limits was used prior to December 2001, there were no pension calculations that resulted in payments exceeding Section 415 caps. The formula used for calculations after December 2001 is under review by an independent actuary

under contract with the Department of Audit. We expect a report with the independent actuary's conclusions by April 8, 2002.

### **Controversy Associated with Regulatory Limits**

As previously noted, media coverage of the wage and benefits package for 2001—2004 intensified in October 2001. In particular, estimates of the pension packages for high level officials and employees generated significant controversy. Pension estimates first appeared on the [www.milwaukee-world.com](http://www.milwaukee-world.com) web site on October 10, 2001. A subsequent article was published in the December 2001 issue of Milwaukee Magazine. The Milwaukee Journal-Sentinel carried a story on the package on January 6, 2002. All of these sources described in detail the very complex provisions of the back DROP benefit.

**It was not until January 15, 2002 that the impact of the IRS caps on reported calculations was acknowledged by Milwaukee County.**

Based on information presented in the stories, the complexity prompted the authors to confirm the accuracy of their calculations with County staff. Yet, it was not until January 15, 2002 that the impact of Section 415 limits was acknowledged by anyone within Milwaukee County government. The following day, the newspaper presented figures prepared for Milwaukee County that dramatically reduced the dollar figures that had been reported for certain individuals. The paper also presented new calculations prepared for them by an independent actuary. While the actuary was not provided with a copy of the ordinance language referencing limits, the actuary confirmed having knowledge of the limits. Thus, the actuary provided the newspaper with both raw calculations and calculations which factored in the caps.

By January 15, 2002 the group seeking to recall the County Executive had organized to the point of establishing a phone line and web site. An exhibit presented by the newspaper on January 16, 2002 highlighted examples of lump sum back DROPs using both “data provided by Milwaukee County” and

estimates considering federal caps. For the County Executive, the lump sum assuming retirement in 2004 was presented as more than \$1.1 million under the first scenario and about \$558,000 under the caps.

#### **Report by Independent Actuary**

We do not anticipate any recommendations from the review of the formula used by ERS staff to calculate pension payments by the independent actuary under contract with the Department of Audit. However, we will forward the independent actuary's report, including any findings and recommendations, to the County Board upon its completion.

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## Section 4: Findings and Recommendations

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In previous sections of this report, we have:

- Provided background on the specifics of how Milwaukee County developed and approved the 2001—2004 wage and benefit package for its employees, and the ensuing controversy over certain aspects of that package.
- Outlined the roles of various County departments and policymakers in developing and adopting the wage and benefit package.
- Based on the public record, created a timeline of the sequence of events that produced the 2001—2004 wage and benefit package adopted by the County Board and signed by the County Executive.
- Identified problems with the fiscal notes prepared to provide policymakers with the fiscal impact of the legislation implementing the wage and benefit package.
- Discussed the inclusion of IRS Code limits on Milwaukee County pension payment calculations.

In this final section of the report, we will detail findings and recommendations for improvement based on our review of the structure and process used to develop and adopt wage and benefit packages for Milwaukee County.

### Findings

Significant pieces of information were omitted, inaccurately presented or unsubstantiated.

- ***Significant pieces of information were omitted, inaccurately presented or unsubstantiated by the administrators responsible for developing the overall strategy and supporting fiscal details for the 2001—2004 wage and benefit package. This was the responsibility of the Executive Branch of Milwaukee County government.***

### Back DROP

As noted in the timeline presented in **Section 1** of this report, the County Board authorized the Director of Human Resources to study the issue of a Deferred Retirement Option Program. However, we were unable to identify any reports indicating such

a study was ever formally performed. Had such a report been prepared, it would undoubtedly have identified the following.

- While gaining popularity across the nation, this pension option has been more commonly used for police and firefighter pension funds.
- Some plans provide for an 'immediate' DROP (lump sum based on reduced future pension payment reduction without any prior year involvement). Other plans provide an option for a 'prospective' DROP (a decision is made to retire at a future date with the intervening years subject to the optional lump sum). Milwaukee County provides for both of these options, but also includes the ability to DROP **retroactively**, choosing a prior date to calculate a lump sum payment and future (reduced) monthly payments, as if the employee had retired on that earlier date.
- Most DROP plans contain limits on the number of years that can be included in the years covered by the option. Generally this limit is between two and five years. In contrast, Milwaukee County employees have no limit to the number of years included in the DROP provision, and can choose a retroactive back DROP date regardless of the number of years involved, provided they were eligible to retire on the date chosen.
- The interest earnings on many plans are lower than the current 9% rate that is applied to the Milwaukee County back DROP. Most plans we found pay between 4% to 7%, base the rate on the actual investment return for their pension fund, or base it on a discounted rate tied to the actual investment return for their plan.
- There are a number of advantages and disadvantages for the employee and the plan fund. Plan features can affect the extent to which either party benefits from a DROP option.
- Assessments of fiscal impacts vary based on plan provisions. While often spoken of as 'neutral,' the true financial impact needs to be identified on a plan-by-plan basis.

**Most DROP plans contain limits on the number of years that can be included.**

Without a formal report, documents show the Director of Human Resources repeatedly attributed no cost to the establishment of a back DROP benefit for Milwaukee County employees. Based on the latest estimates of the ERS actuary, the annual cost of this benefit is \$1.4 million.

**The ERS actuary estimates the annual cost of the back DROP benefit to be \$1.4 million.**

### Unused Sick Leave Payout

As previously noted, this costly benefit enhancement was omitted from the fiscal notes due to an error in logic. A lack of understanding of the underlying data gathered on sick leave payouts resulted in the flawed conclusion that there was no cost to the elimination of a previously imposed cap on this benefit.

As of March 2002, the County has paid \$4.3 million for this benefit enhancement, and we estimate an additional \$2.6 million will be paid as a result of the enhancement through 2004. (It should be noted that the cost in 2002 was accelerated by the County's action, in February 2002, to rescind this benefit enhancement for all new hires and all current non-represented employees as of March 15, 2002.)

### Overtime Costs Related to Abuse of Sick Leave

Documents show that the strategy for lifting the previously imposed cap on unused sick leave payouts was based, in part, on the argument that overtime costs were incurred as a result of the need to 'cover' for employees abusing sick leave. However, there was never any estimate provided of the extent to which overtime costs resulted from this alleged abuse. Neither was there ever any estimate provided of the anticipated reduction in sick leave as a result of this measure.

**We estimate for every 1% reduction in sick leave usage, the County saves \$70,000.**

Based on 2000 and 2001 data, we estimate for every 1% reduction in sick leave usage, the County saves approximately \$70,000. In January 2002, after public criticism of the sick leave payout enhancement, the administration indicated that use of sick leave had declined by 4.2% in 2001, attributing this reduction to the enhanced unused sick leave payout benefit. Our review of the data used to support this statement showed that the actual decline was 2.6%. Therefore, we estimate the direct savings from reduced sick leave usage in 2001 was approximately \$182,000. Based on information provided by departments with 24-hour operations, we estimate the indirect

**No cost was ever provided concerning the resulting increased overtime costs associated with added vacation and holiday time.**

savings (i.e., reduced overtime) associated with this reduction in sick leave usage is approximately \$30,000. Therefore, to the extent all of the reduction in sick leave usage in 2001 is attributable to the enhanced payout benefit, the County spent \$884,000 (the increased cost of the sick leave payout enhancement in 2001) to save \$212,000 (\$182,000 in reduced sick leave usage plus \$30,000 in associated overtime costs).

#### Increased Vacation and Holiday Time

Similarly, no cost was ever provided concerning the resulting increased overtime costs associated with added vacation and holiday time. Based on departmental estimates, we calculated this benefit enhancement to cost an average of about \$350,000 per year.

#### Savings Attributable to Reduced Wage Increases

In a memo from the Director of Human Resources and the Director of Labor Relation to the County Executive dated April 14, 2000, the strategy of achieving lower wage increases (generally funded through property taxes) by offering enhanced pension benefits (partially funded through pension investment earnings) was recommended. The memo stated:

“A recently published national management newsletter indicates that, although inflation is estimated to be only 2.7%, wage rates will rise by an estimated 4.2%....”

However, documents obtained from the Department of Labor Relations show that survey information available at that time indicated local wage settlements for various groups of individuals employed by area municipalities averaged 3% for 1999, 2.8% for 2000, 2.9% for 2001 and 3.1% for 2002. Settlements with specific groups ranged from 1% to 3.5%.

We obtained information on non-represented wage settlements from the State of Wisconsin and three area local governments

for 2001 and 2002. **Table 6** shows the general wage increases for those entities.

<b>Table 6</b> <b>General Wage Increases for Non-Represented Employees</b> <b>2001 and 2002</b>		
	<u>2001</u>	<u>2002</u>
City of Milwaukee	2.5%	3%*
Milwaukee Public Schools	3%	3%
Waukesha County	3%	3%
State of Wisconsin	1%	2%
<b>Milwaukee County</b>	<b>2% (mid-year)</b>	<b>3%**</b>
<p>* Repealed for all employees making \$50,000 or more.</p> <p>** For all non-represented employees (excluding Executive Compensation Plan employees); revised to 2% beginning of year plus 2% mid-year. ECP employees received a general increase of 3%, with no mid-year adjustment.</p> <p>Source: Department of Labor Relations.</p>		

#### Retention Problem

Much of the underlying strategy for the enhanced benefits contained in the 2001—2004 wage and benefit package was predicated on the notion that a tight labor market necessitated either a large general wage increase or the increased benefits for purposes of retaining current County employees. The following benefits were included in the package based on this perceived need to create retention incentives.

- The 7.5% per year retention 'bonus,' up to a maximum of 25%, added to the pension payments of employees hired prior to 1982.
- The addition of one week of vacation for 15-year and 20-year veteran employees, respectively.
- The back DROP option.

However, at no time does the record reflect the presentation of any data documenting an actual problem concerning the departure of experienced County employees.



**The public record does not reflect a substantive degree of questioning or scrutiny by the Legislative Branch of Milwaukee County government.**

- ***The public record does not reflect a substantive degree of questioning or scrutiny by the Legislative Branch of Milwaukee County government.***

Under Wisconsin State Statutes, there is no requirement that any record be maintained documenting the specifics of information presented or discussions that transpire during closed sessions of the County Board Personnel Committee. The lack of any formal record limits the public's ability to assess the degree of scrutiny applied by policymakers under those circumstances. Any attempt to provide a summary record of closed session discussion of wage and benefit package issues, for disclosure at some future date, would need to be balanced against the need to prevent creating a strategic disadvantage for the County in labor negotiations.

As for open proceedings, the public record reflects little or no discussion of details contained in the 2001—2004 wage and benefit package at any open Personnel Committee meeting during the fall of 2000 or early 2001. Similarly, tapes of the full County Board meeting confirm that there was no discussion of the initial package adopted, which applied to non-represented employees.

Further, we reviewed handouts provided at a briefing session for County Board Supervisors, conducted by the Director of Human Resources and the ERS actuary in July 2001. This briefing session appears to be the most detailed information related to the strategy and costs of the wage and benefit package, adopted some six to eight months earlier, presented and explained to Supervisors.

One exception stands out concerning the degree of questioning and scrutiny exhibited in the public record by policymakers concerning the wage and benefit package. That exception is the Pension Study Commission. The record reflects repeated questioning of the ERS actuary by Commission members

**The record reflects repeated questioning of the ERS actuary by the Pension Study Commission.**

concerning the potential impact of proposed benefit changes on the health of the pension fund. However, despite complaints that only 24 hours notice had been provided to Commission members to study the proposed changes, Commission members ultimately accepted, with a 3-2 vote, assurances by the actuary that the pension fund was healthy and that the benefit changes would not place the pension fund in jeopardy. Indeed, the \$1.5 billion Milwaukee County ERS Pension Fund remains secure more than a year after the benefit changes.

- ***Certain correspondence indicates the possibility of an inappropriate use of the ERS actuary. One request in particular suggests the possibility of ‘shopping’ for an assumed actuarial rate of return on investments to manipulate the estimated cost of a pension benefit change.***

**Annual contributions to the pension fund by Milwaukee County are based on the recommendation of the actuary.**

#### Role of the Actuary

The Milwaukee County Employees’ Retirement System Pension Fund derives revenues primarily from two sources: employer (County tax levy) contributions and investment income. Annual contributions by Milwaukee County are based on the recommendation of the actuary, who must certify that the annual employer contribution is adequate to meet current and future obligations.

Each year, actual employer contribution payments differ somewhat from budgeted amounts. This is partly because of timing differences in the County’s annual budget preparation process and the date of the annual employer contribution to the ERS pension fund. It also is due to differences in the actual experience of County payroll changes, employee retirement decisions and other factors, from actuarially assumed rates. Such differences are typically minor and are customarily ‘smoothed out’ over a long amortization period by the actuary in the recommended figure for the following year’s annual employer contribution.

**The actuary was instructed to prepare cost estimates using four different assumed rates of return.**

As noted in the timeline presented in **Section 1** of this report, in June of 2000, the Director of Human Resources, in response to questions by the County Executive, requested information from the ERS actuary. The ERS actuary was instructed to prepare calculations of the costs of several potential pension benefit enhancements using four different assumed rates of return on investment (0%, 5%, 8.5% and 12%). An argument could be made that it is prudent to request a full range of numbers to obtain a full understanding of the potential consequences of a proposed benefit change under best and worst case scenarios.

However, actuarial assumed rates of return are based on long-term trends. Cost estimates for fiscal notes should be obtained by asking the actuary the projected cost of a benefit change using the current assumed rate of return established by the Pension Board. The exercise of requesting various cost estimates for the same benefit change, under different assumed rates of return, could lead to a perception of ‘shopping’ for a palatable cost figure. Such perceptions were fostered when, by a vote of 4-3 (with the four members of the Pension Board appointed by the County Executive voting in the affirmative), the assumed rate of return was increased from 8.5% to 9% in September 2001. This change eliminated the need for the County to contribute \$8.2 million to the Pension Fund in 2002.

- ***There are no procedures for the development of fiscal notes. The practice of including only the incremental cost of multi-year packages significantly understates the full fiscal impact of the authorizing legislation.***

Our review of the process used to develop the strategy and fiscal information for the 2001—2004 wage and benefit package identified the need for better coordination between the Departments of Human Resources, Labor Relations and Administration. The fact that the County Controller was not informed of the change in sick leave payout benefit, which had significant accounting implications affecting the County’s bottom

**It appears that placement of overall responsibility for development of fiscal notes for the package with the Director of Human Resources resulted in some critical errors and omissions.**

line, is evidence of the need for better coordination. Specifically, in retrospect, it appears that placement of overall responsibility for development of the fiscal notes for this complex package with the Director of Human Resources, without input from DOA fiscal staff, resulted in some critical errors and omissions. In the 2002 Adopted Budget, the Department of Labor Relations was organizationally placed under the Department of Administration. This should provide the opportunity for improved coordination between Labor Relations and DOA fiscal staff.

We also noted that there is no record that the County Board ever saw a figure estimating the combined fiscal impact of the 2001—2004 wage and benefit package. Rather, the fiscal notes were assembled piecemeal for each of 15 separate resolutions. While the various union agreements had minor differences that affected the eventual fiscal notes, it would appear that an overall estimate of the combined impacts should have been presented to provide a more complete understanding of the overall impact of the package.

### **Recommendations**

To address the findings in this report, we recommend the Milwaukee County Board of Supervisors adopt measures to ensure the following recommendations are implemented.

1. *Greater scrutiny of underlying assumptions and purported 'problems' is necessary to effectively provide the checks and balances envisioned with the Executive/Legislative form of governance. (Resolution File No. 02-56 requiring review of fiscal notes by DOA, Director of Audits and Director of County Board Research is a good step in this direction already adopted by the County Board.) Scrutiny of fiscal note estimates, including input from the Controller, should begin at the point at which agreement is reached on an overall negotiating strategy.*
2. *In consultation with Corporation Counsel, a method should be developed for documenting, in summary form, information presented and ensuing discussion of Personnel Committee proceedings in closed session. Care would need to be exercised to create a process that creates a public record,*

*but prevents untimely disclosure of records such that the negotiating position of the County would be compromised.*

- 3. Require that the Pension Study Commission receive notice, along with materials for review, of proposed changes to the pension plan at least 30 days in advance of making a formal recommendation to the County Board.*
- 4. Require that any queries by the County of the ERS actuary concerning the estimated costs of proposed pension benefit changes be based on the existing actuarial assumed rate of return for the pension fund. If a best and worst case scenario is desired, the range should be requested of the actuary based on the actuary's best judgement, not articulated by the County.*
- 5. Develop minimum criteria for inclusion in fiscal notes, including the use of a full cost methodology.*

## Audit Scope

On January 24, 2002 the Milwaukee County Board authorized and directed the Department of Audit to conduct a review of the structural and procedural problems that led to the recent County pension controversy. Our audit included developing and reviewing a timeline of the specific events that led to the problems. Further, we performed a verification of the underlying data, or lack thereof, supporting the fiscal notes associated with the 2001—2004 wage and benefit package. The audit was conducted under standards set forth in the United States General Accounting Office *Government Auditing Standards*, with the exception of the standard related to periodic peer review. It is anticipated our next peer review will be conducted in 2004. Further, due to the nature of the project, an auditee response was not applicable. We limited our review to the items specified in this Scope section. During the course of this audit, we performed the following tasks.

- Based on public record, reviewed available resolutions, memos, reports, correspondence, etc. regarding the 2001—2004 wage and benefit package.
- Interviewed and/or questioned various current County managers and staff regarding events, correspondence and circumstances relating to the 2001—2004 wage and benefit package.
- Listened to tapes of meeting minutes of the County Board, Personnel Committee and the Pension Study Commission.
- Examined documentation and had several discussions with the County's outside actuary.
- Reviewed all wage and benefit package fiscal notes and conducted an independent verification of the underlying data upon which the fiscal notes should properly have been based.
- Reconstructed fiscal notes using a conceptual approach which identifies the full cost of associated actions.
- Obtained information on non-represented wage settlements from the State of Wisconsin and three local area governments for 2001 and 2002.
- Researched via the internet information regarding the popularity and use of back DROP pension option plans.